OPEN MEETING AGENDA ITEM

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
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ORIGINAL

IN THE MATTER OF THE APPLICATION OF VALENCIA WATER COMPANY—TOWN DIVISION FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERTY THROUGHOUT THE STATE OF ARIZONA.	**DOCKET NO. W-01212A-12-0309**
IN THE MATTER OF THE APPLICATION OF GLOBAL WATER-PALO VERDE UTILITIES COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERTY THROUGHOUT THE STATE OF ARIZONA.	**DOCKET NO. SW-20445A-12-0310**
IN THE MATTER OF THE APPLICATION OF WATER UTILITY OF NORTHERN SCOTTSDALE FOR APPROVAL OF A RATE INCREASE.	**DOCKET NO. W-03720A-12-0311**
IN THE MATTER OF APPLICATION OF WATER UTILITY OF GREATER TONOPAH FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERTY THROUGHOUT THE STATE OF ARIZONA.	**DOCKET NO. W-02450A-12-0312**

IN THE MATTER OF THE APPLICATION OF VALENCIA WATER COMPANY—GREATER BUCKEYE DIVISION FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERTY THROUGHOUT THE STATE OF ARIZONA.	**DOCKET NO. W-02451A-12-0313**
IN THE MATTER OF THE APPLICATION OF GLOBAL WATER—SANTA CRUZ WATER COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERTY THROUGHOUT THE STATE OF ARIZONA.	**DOCKET NO. W-20446A-12-0314**
IN THE MATTER OF THE APPLICATION OF WILLOW VALLEY WATER COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERTY THROUGHOUT THE STATE OF ARIZONA.	**DOCKET NO. W-01732A-12-0315**

COMMENTS TO EXCEPTIONS FILED BY RUCO AND GWR TO RECOMMENDED OPINION AND ORDER DATED JANUARY 21, 214

ON BEHALF OF
SIERRA NEGRA RANCH, LLC AND SIERRA NEGRA MANAGEMENT, LLC
FEBRUARY 4, 2014

Sierra Negra Ranch ("SNR") by and through undersigned counsel, hereby files its Comments to Exceptions filed by RUCO and Global Water Resources LLC ("GWR") to the Recommended Opinion and Order ("ROO") dated January 21, 2014.

I. OVERVIEW

In its Closing Briefs, SNR requested that the Commission, as a condition for approving the Settlement Agreement:

- Regulate the transactions of GWR, either through a detailed regulation of each of its subsidiaries so that each and every intercompany transaction related to the Infrastructure, Coordination, Finance and Option Agreement ("ICFA"), between GWR and its subsidiary utility company is reviewed in detail; including the financing associated with construction of such infrastructure, which is dependent on the balance sheets of GWR and that the traditional regulatory process relating to utility oversight is fully followed either by direct jurisdiction over GWR or through an intense review of all the transactions that GWR is involved in which, in essence, are providing utility services. (Transcript Vol. II at 233 [O'Reilly Testimony]).

- Require GWR to segregate all funds received under ICFAs, including past payments (and payments due or paid by December 31, 2012). (SNR-1 at 14). The prior payments and all payments made hereafter must be protected and segregated for use pursuant to the provisions of the applicable ICFA as provided by Section 6.4.1 of the Settlement Agreement, including funds paid under the ICFA but earmarked to secure GWR's indebtedness to Regions Bank as described herein. (A-17 at 9).

- Require that there be a tie between the HUF that is proposed in the settlement and the obligations under the ICFAs including tying future increases in HUFs to the CPI adjuster. In addition, SNR and New World Properties, Inc. ("NWP") should not have to pay a CPI adjuster on the funds that they are paying towards getting utility service (and treated as contributions in aid of construction) to Water Utility of Greater Tonopah ("WUGT") and Hassayampa Utility Company ("HUC"), when other similarly-situated developers will not have to pay similar escalators on their hookup fees in the future.

- Notwithstanding the language of Section 6.4.4 of the Settlement Agreement which provides for a 70%-30% split of future payments to GWR under the ICFAs, require that the Commission Final Order

("Order") make clear that NWP, SNR and all other parties to ICFAs may fully fund applicable HUFs due to the utilities that will provide service to the property covered by the ICFAs.

- Require GWR to amend its ICFA to make clear that monies allocated to WUGT and HUC as HUFs may be paid directly to WUGT and HUC.

- Require GWR and its non-regulated affiliates to agree to submit to the jurisdiction of the Commission regarding enforcement of the terms of the Settlement Agreement and the Order approving the Settlement Agreement, and waive the right to assert that the Commission lacks jurisdiction over GWR and its non-regulated affiliates.

- Require GWR to provide annual reports certified by an officer of GWR and its regulated subsidiaries allowing for verification of compliance with all obligations imposed under the Settlement Agreement. Given the complexity of GWR's corporate structure, such certification should also include Global Water Resources Corp. ("Global Water"), parent of GWR.

- Require that all monitoring of the terms and conditions of compliance to the Settlement Agreement by GWR and its affiliates be specifically spelled out in the Order to avoid any ambiguity as to how Staff and RUCO would monitor such compliance.

- Require that any Code of Conduct developed and approved by Staff and RUCO also apply to Global Water, as well as all other GWR affiliates.

- Require both GWR and the regulated utilities to guarantee that the monies paid under the ICFA are used to construct infrastructure contracted for even if the parent goes bankrupt. (SNR-1 at 16).

On January 21, 2014, Administrative Law Judge Dwight D. Nodes published the ROO in which he recommended the Commission approve the Settlement Agreement as long as several additional requirements are imposed as a condition of approval. These included:

1. Global Water will be required to permit developers that are parties to ICFAs to fully fund the applicable hook-up fees ("HUFs") out of the developer payments that are due under the ICFAs. (See ROO at 29).

2. Developers that are parties to ICFAs will be permitted to pay the HUF amounts directly to the applicable water or wastewater utilities, rather than to Global Parent, as is currently required under the ICFAs. (See ROO at 30).

3. All of the Global Water entities, including GWRI, will be required to submit annual affidavits, signed by the highest officer of each entity, attesting that each of those signatory entities was compliant with the terms of the Settlement Agreement for the prior calendar year. (See ROO at 30).

4. The CPI adjuster included in the ICFAs will be tied to the HUF fees that were agreed to in the Settlement. Therefore, in order to level the playing field between competing landowners/developers, the CPI adjuster will not be applied to funds received from developers for HUFs. (See ROO at 30).

GWR has no objection to conditions Nos. 1-3 but is opposed to condition No. 4. SNR supports the terms and conditions of the ROO. If the Commission adopts the ROO with the above requirements as a condition of approving the Settlement Agreement, SNR would support the Settlement Agreement.

II. ICFAS

Although GWR currently has entered into 172 ICFAs[1] throughout Arizona, GWR did not seek any approval by the Commission.[2] The only purpose of the ICFA was to facilitate and arrange the provision of a regional solution for water, wastewater and reclaimed water services or to provide "Utility Services" to developers. (SNR-1 at 5). ICFAs were structured to take responsibility for water planning away from developers/homebuilders; (S-2 at 4). There is a blurred line between GWR and the regulated GWR utilities under the provisions/obligations associated with these ICFA agreements. GWR caused this blurring by including deliverables traditionally provided by regulated utilities in the list of obligations GWR undertook under the ICFA as Coordinator. (S-2 at 17). Many of the ICFA agreement-related activities assumed by the GWR as the Coordinator would traditionally be the responsibility of the underlying regulated utility. (S-2 at 18). GWR provided no choice to developers but to enter the ICFA. Developers were not given any other choice but to enter into the ICFA. In addition, GWR acted at all times as the regulated utility with the monopoly by demanding payments under the ICFAs for the

[1] Hearing Transcript Vol. I at p. 86, lines 9-11.
[2] Hearing Transcript Vol. I at 151-153.

provision of utility services. (SNR-1 at 15). GWR could have come to the Commission to get the ICFAs approved as is customary for utility companies seeking financing approval. GWR made a business decision not to get these financing agreements approved. As such the Commission should assert jurisdiction over GWR and its business activities related to the ICFAs.

III. COMMENTS TO RUCO'S EXCEPTIONS

RUCO asserts that exempting the CPI adjustor from the HUF fee consideration would result in a decrease in the amount of CIAC as the HUF fee increases, which will result in an increase in rates. (See RUCO Exceptions at 3). First, there is no evidence, expert or otherwise, in the record to support this contention. Furthermore, RUCO's assertion that by eliminating the CPI will result in lower CIAC is speculative at best. Currently only the HUF amount is payable to the regulated utilities. The additional $2,000 for each dwelling of "EDU" that is due under the ICFA, plus the CPI adjuster that will attach to those monies in excess of the HUF is payable to GWR, not the regulated utilities. In addition, there is no evidence that any monies paid under the CPI adjuster would be used by the underlying regulated utilities to construct infrastructure, or that the monies paid would even be classified as CIAC. In fact, in this case, the major concession of all the parties to the Settlement was to allow GRW to de-impute CIAC back to equity. Historically, GWR has treated all funds collected under the ICFAs as equity, not CIAC. In GWR's last rate case, Staff and RUCO opposed such ratemaking treatment of ICFA funds and recommended that such funds be treated as CIAC. This recommendation was adopted by the Commission in Decision No. 71878. But for an order of this Commission to force GWR to impute as CIAC, those monies collected under the ICFA's, it would have never occurred.

Next, RUCO states that "the Company raises a good point regarding the interference of the Commission in private contracts (See RUCO Exceptions at 3). This issue is addressed in Section IV.c below. Then RUCO states "Unless absolutely necessary, RUCO believes such interference, at the very least is not good public policy." (Id.). It appears that RUCO agrees that

in certain instances, such interference by the Commission is not only allowed, but sometimes necessary. SNR contends that such interference is absolutely necessary when a contract is entered into by an entity acting as a public service corporation and the terms of such contract are "unreasonable," "unjust" and "discriminatory."

IV. COMMENTS TO GWR'S EXCEPTIONS

a. CPI CLAUSES ARE DISCRIMINATORY.

GWR argues that "it is not discrimination to hold sophisticated developers to contracts they knowingly signed with Global Parent and that SNR and New World Properties Inc. ("NWP") received great benefits from ICFAs that will not be available to developers who only pay the HUF's" (See Global's Exceptions at 2.)

First, this contention that the developers "knowingly signed" ICFAs ignores the evidence at hearing that showed that the only realistic option for SNR and NWP to obtain utility services was to enter into an ICFA and as a result, had no other choice. The record supports the following:

- At the time the ICFA was entered into with GWR, Maricopa County mandated Regional Infrastructure to support zoning. (SNR-1 at 7).
- SNR and New World Properties, Inc. ("NWP") were specifically told by Maricopa County Planning and Zoning authorities that developers needed to provide a regional and consolidated approach to water and wastewater utilities to their properties or such developments would not be approved. (Transcript Vol. II at 295 [Jellies Testimony]).
- In order to proceed with entitlements, Maricopa County demanded a regional solution and mandated that SNR have a water provider and an approved 208 Permit. (SNR-1 at 7).
- The only option presented to SNR (and NWP) was either to become a utility themselves or sign an ICFA with GWR. (*Id.*).
- GWR represented to SNR that the ICFA was part of a regional water and wastewater infrastructure development plan supported by the Arizona Corporation Commission ("Commission"). (*Id.*).
- Neither SNR nor NWP was ever offered a conventional Main Extension Agreement or Master Utility Agreement by GWR to provide utility services to their properties. (Transcript Vol. II at 314 [Jellies Testimony]).

- GWR directed SNR and NWP that they must enter into an ICFA because of the financing need for GWR to acquire Western Maricopa Combine Inc., ("WMC") an Arizona corporation and the holding company for five regulated water utilities including WUGT and Hassayampa Utility Company ("HUC"). (Transcript Vol. II at 314 [Jellies Testimony]).

In addition, SNR and NWP refuted at hearing, GWR's argument that SNR and NWP: (1) could have worked with the prior owners of WMC; (2) worked with Balterra Sewer Corp; or (3) could have formed their own utility. Evidence at hearing was as follows:

- Although SNR and NWP did meet with the prior owners of WMC, WMC did not meet and push towards consolidation and regionalized infrastructure that the Commission and the County was looking for; WMC did not have any desire to do regional planning; the WMC service territory did not incorporate all of the lands owned by SNR and NWP and a piecemeal approach to utility service would have been necessary. (Transcript Vol. II at 295 [Jellies Testimony]).
- Because SNR's and NWP's properties are bifurcated by Interstate 10, using Balterra as a wastewater provider would have resulted in a situation where SNR and NWP had one wastewater provider servicing the north properties and one wastewater provider servicing the south properties; neither SNR nor NWP believed that Balterra met the regionalization standard that was required to be pursued by the County; and at the time SNR and NWP was considering this option, Balterra's CC&N application and 208 permit application were pending (GWR filed a competing 208 application which SNR and NWP supported due to the regional nature of GWR). (Transcript Vol. II at 296-297 [Jellies Testimony]).
- Although forming their own utility company was also considered, SNR and NWP were told unequivocally by the Commission that they were not necessarily looking to have small water companies formed. (Transcript Vol. II at 297 [Jellies Testimony]). The Commission was looking to consolidate water companies. (*Id.*). Given WMC had portions of SNR's and NWP's properties within its CC&N, this option was not seriously pursued. (*Id.*).

Because Section 6.2.1 of the Settlement Agreement prohibits Global and any of its affiliates from entering into any more ICFAs, backbone utility infrastructure will now be funded exclusively through HUFs. By establishing a HUF, the Settlement Agreement inadvertently creates another class of developer (Transcript Vol. II at 288 [Jellies Testimony]) that has not

entered into an ICFA, that would clearly have a cost advantage. (SNR-1 at 15). This is compounded by the added CPI adjuster that at hearing was calculated at $1.7 million for NWP and $4 million for SNR. (Transcript Vol. I at 127 [Fleming Testimony]). Currently that number is much higher and growing. There are no HUFs approved by the Commission that have an adjuster mechanism or CPI adjuster. By recommending a HUF in this case, Staff has attempted to provide the Commission with a mechanism to regulate a portion of GWR's ICFA payments. The problem is that by only regulating a portion, a cost discrepancy for plant occurs.

In addition, the ICFAs provide for a renegotiation of the CPI Factor in the event that it "results in a Landowner Payment in excess of related financing requirements." (SNR-1, Exhibit 2 at 15). By designating $3,500 of the Landowner Payment as a HUF under the Settlement Agreement, this amount is no longer includable as part of the "financing requirements" under the ICFA and an Order of the Commission modifying the CPI adjuster under the ICFA as it applies to the re-characterized HUFs would be consistent with the language of the ICFA itself and fall under the Commission's authority.

Furthermore, because the ICFA contains a "Most Favored Nation" clause (SNR-1, Exhibit 2 at 33), the adoption of the Settlement Agreement without a corresponding amendment to the CPI adjuster will effectively eviscerate the "Most Favored Nation" clause of the ICFA and an Order of the Commission modifying the CPI adjuster would be fully consistent with the spirit of that provision of the ICFA.

GWR asserts that SNR and NWP received great benefits from ICFAs. In fact, SNR has already paid approximately $6 million dollars to GWR with an additional $4 million to be paid by March 2014 for a total of $10 million (SNR-1 at 13). NWP has paid $3.75 million under its ICFA. (NWP-4 at p. 4, lines 4-5). Yet despite significant monies already paid to GWR, there have been no homes constructed at either of the SNR or NWP developments and no utility infrastructure is in place to serve such developments. (Transcript Vol. I at 96 [Fleming Testimony]).

b. THE CPI PROVISION SHOULD NOT IMPACT RATES.

GWR argues that "by eliminating the CPI on a portion of the ICFA fees, the CPI condition in the ROO would take away this pool of funds, thus potentially limiting the Commission's ability to increase HUF's in the future." (*See* Global's Exceptions at 6). As set forth in Section III above, First, there is no evidence on the record to support such a contention. In addition, as set forth above, currently only the HUF amount is payable to the regulated utilities. The additional $2,000 for each dwelling of "EDU" that is due under the ICFA, plus the CPI adjuster that will attach to those monies in excess of the HUF is payable to GWR, not the regulated utilities. In addition, there is no evidence that any monies paid under the CPI adjuster would be used by the underlying regulated utilities to construct infrastructure, or that the monies paid would even be classified as CIAC. In fact, in this case, the major concession of all the parties to the Settlement was to allow GRW to de-impute CIAC back to equity. Historically, GWR has treated all funds collected under the ICFA's as equity, not CIAC. In GWR's last rate case, Staff and RUCO opposed such ratemaking treatment of ICFA funds and recommended that such funds be treated as CIAC. This position was adopted by the Commission in Decision No. 71878. But for an order of this Commission to force GWR to impute as CIAC, those monies collected under the ICFAs, it would have never occurred.

c. CASE LAW DOES NOT PROHIBIT COMMISSION FROM MODIFYING ICFA.

GWR argues that the Commission cannot change or modify a contract that was voluntarily entered into between two private parties. (See Global Exceptions at 8, *citing*, *General Cable Corp. v. Citizens Utilities Co.*, 27 Ariz.App. 381, 555 P.2d 350 (1976)). GWR's reliance on the *General Cable Corp.* case is misplaced. First, SNR and NWP have asserted throughout this proceeding that if they wanted utility service, they had no choice but to enter into the ICFA (*See,* SNR Reply Brief Section II.C.). The record supports SNR and NWP's contention that the ICFAs

were not entered into voluntarily. Next, the *General Cable Corp.* case has no applicability to the facts of this case. In *General Cable Corp.,* the Court determined that the charges under contract at issue in that case "including the minimum charges," were not, "as a matter of law, unjust, unreasonable or discriminatory." *General Cable Corp.*, 27 Ariz.App. at 384, 555 P.2d at 353. As discussed above, SNR and NWP have asserted that the ICFA and Settlement Agreement create a competitive disadvantage for SNR and NWP (See SNR Reply Brief Section II D.) and that the resulting charges to both SNR and NWP are "unreasonable," "unjust" and "discriminatory." (*See,* SNR Reply Brief Section III.D). As such, the Commission has the authority, as a condition of approving the Settlement Agreement, to require GWR to modify the ICFA to address SNR's and NWP's concerns. (*See*, SNR Reply Brief Section II.A.).

Next, GWR argues that the proposed CPI condition would "impair the obligation of a contract," violating the contract clause of the Arizona Constitution (Article 2, Section 25). (*See* Global Exceptions at 8.). GWR also cites Staff's Closing Brief of Staff to support the contention that the Commission "cannot change or modify a contract that was voluntarily entered into between two private parties." (See Staff's Initial Brief at 26, *citing*, *Application of Trico Electric. Co-Op.,* 92 Ariz. 373, 387, 377 P.2d 309 (1962)). As in the *General Cable Corp.* case, the Court was not dealing with a contract that was not voluntarily entered into or produced rates and charges that were "unreasonable," "unjust" and "discriminatory." By GWR intervening in this rate case, GWR has consented to Commission jurisdiction. (SNR-1 at 12). In addition, "Global has never contended that ICFAs are non-jurisdictional." (SNR-1 at 13). In any event, the Commission has the authority, as a condition of approving the Settlement Agreement, to require GWR to modify the ICFA to address SNR's and NWP's concerns. (*See*, SNR Reply Brief Section II.A.).

Finally, although GWR assert that SNR and NWP are the "only two complaining developers here" (See Global's Exceptions, p. 2), only the ICFAs entered into by SNR and NWP

(two out of the 172 ICFAs) required a $1,000 per EDU payment before a start work notice was issued.[3]

V. CONCLUSION

Applying the CPI adjustor landowner fees re-characterized as HUFs pursuant to the Settlement Agreement and failure to do so on HUFs payable by developers without ICFAs creates an unlevel playing field that competitively disadvantages developers with ICFAs. This unfair and discriminatory result is remedied by requiring the elimination of the CPI adjustor as it applies to landowner fees that are re-characterized as HUFs under the Settlement Agreement. Without such a condition, approval of the Settlement Agreement is not in the public interest. For all of the reasons set forth herein, NWP requests that the Commission approve the ROO as written.

RESPECTFULLY SUBMITTED this 4th day of February, 2014.

MUNGER CHADWICK, P.L.C.

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[3] As described above, SNR will have paid approximately $10 million dollars to GWR by March 2014 under its ICFA and NWP has paid $3.75 million.

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